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The Benefit Corporation: From CSR Label to Hybrid Corporate Form

Posted on [April 8, 2015](#) by [Remus Valsan](#)

Corporate social responsibility is the new norm in business. With the rapid growth of socially conscious customers,[\[1\]](#) employees[\[2\]](#) and investors,[\[3\]](#) no company can afford to ignore CSR. Green, responsible, sustainable, ethical or socially conscious have become staple terms to describe products or business strategies. Businesses that are genuinely committed to corporate social responsibility find it increasingly difficult to distinguish themselves from competitors that make similar claims but do not actually share the vision. This problem, often referred to as “greenwashing,” is affecting ethically-minded consumers, investors, and businesses alike.

Third-party certification is an important remedy against greenwashing. In both Europe and the US, social and environmental labelling initiatives have multiplied in recent years.[\[4\]](#) These labels usually certify a specific product (e.g. “Organic” or “Fair Trade” coffee), facility (e.g. a “LEED” or “Energy Star” building) or line of business (e.g. “Rainforest Alliance” farms or forestry companies). They do not offer a complete picture of a company’s performance across all relevant environmental, social and governance indicators.

To address this gap, B Lab, a Pennsylvania-based not-for-profit organisation, has created a certification system for businesses wishing to be recognised as genuinely committed to social responsibility. In 2007, B Lab launched a certification programme that evaluates businesses (incorporated or non-incorporated) against a set of rigorous social, environmental, accountability and transparency standards. Unlike CSR certifications that target a particular product or line of business, the B Lab certification applies across all product lines and issue areas of the certified entity. Businesses that achieve the minimum performance standards and meet the legal requirements become certified benefit corporations (or certified B Corps).[\[5\]](#)

To date, over 1,200 businesses from 38 countries have the status of certified B Corporation.[\[6\]](#) These tend to be start-ups or small businesses, but a few house-hold names such as Ben and Jerry’s or Patagonia have also joined the B Corp family. Although increasingly popular, the B Corp certification has no legal status: it is simply a label provided by a private organisation, without any specific legislative framework or legal consequences attached to it. The B Corp certification is thus mainly a marketing tool that enhances the visibility of socially responsible businesses wishing to distinguish themselves from greenwashing competitors. It does not address the legal obstacles that mission-driven for-profit companies face in the US and elsewhere. Chief among these obstacles is the deeply ingrained view that the core role of managers of business corporations is to maximise shareholders’ wealth.

Fiduciary duties and the US constituency statutes

Milton Friedman, Nobel Prize laureate and one of the twentieth century’s most prominent advocates of free markets, famously stated that the one and only social responsibility of a business corporation is to increase its profits by all available legal means.[\[7\]](#) US corporate law largely reflects this view: the current legal framework is structured to ensure profit maximisation, not social responsibility.[\[8\]](#) The Michigan Supreme Court forcefully articulated this idea almost a century ago, in *Dodge v. Ford Motor Company*.[\[9\]](#) The company’s president and majority shareholder, Henry Ford, sought to use the corporate profits to subsidise car price reductions and to increase employment, instead of distributing dividends. Henry Ford’s vision is a textbook example of genuine

CSR: the interests of customers and employees were ends in themselves, rather than mere means to shareholder wealth maximisation. This, however, was the very reason why the court found Henry Ford's decision flawed:

A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes. [\[10\]](#)

The current American corporate law remains largely unchanged. A board's decision to use retained earnings to finance price reductions or to increase employee salaries is immune from shareholder attack only if it is justified as a device to increase long-term shareholder wealth.

The constituency statutes adopted by a majority of US states over the past two decades have not redressed the balance between shareholders and other constituencies. The constituency statutes were adopted in response to the wave of hostile leveraged buyout transactions of the 1980s. These transactions were often highly detrimental for non-shareholder constituencies. The typical hostile acquirer replaced incumbent senior managers, sold off core corporate assets, laid off employees and increased significantly the corporate debt. Intense managerial lobbying led to the rapid adoption by state legislatures of non-shareholder constituency statutes.

These statutes grant directors the power (but, with very few exceptions, not the duty) to balance the interests of other corporate constituencies against the interests of shareholders in setting the corporate policy. The constituency statutes offer little in the way of genuine CSR. They neither displace shareholder wealth maximisation nor give directors the power to advance the interests of other stakeholders as ends in themselves. Moreover, none of these statutes grants any non-shareholder constituency the right to sue directors for failure to take their interests into account. [\[11\]](#)

Delaware, the most important corporate law jurisdictions in the US, [\[12\]](#) does not have a constituency statute. The Delaware Supreme Court has ruled that, in creating anti-takeover defences, the board may consider the interests of other constituencies only if there is a related benefit to the long-term shareholder value. [\[13\]](#) In a recent decision, the Delaware Court of Chancery reaffirmed that there is very little scope for genuine CSR in Delaware law, both in the regular course of business and in a change of control scenario.

eBay Domestic Holdings, Inc. v. Newmark [\[14\]](#) concerned the validity of the business model adopted by Jim Buckmaster and Craig Newmark, the founders of the free classifieds website Craigslist. Buckmaster and Newmark were majority shareholders and directors of Craigslist. Their business plan was to operate the company in the interest of the community as a whole, by maintaining nearly all classified advertisements free of charge. Although a for-profit business, Craigslist's business culture and values placed customers ahead of shareholders. Buckmaster and Newmark adopted a series of protective devices (including a shareholder rights plan) which allowed them to protect their business vision against eBay, a disgruntled shareholder.

Chancellor Chandler held that, in most instances, genuine CSR is incompatible with the for-profit corporate form. In a for-profit corporation, a policy that does not seek to maximise shareholder value is inconsistent with directors' fiduciary duties:

I personally appreciate and admire Jim's and Craig's desire to be of service to communities. The corporate form in which Craigslist operates, however, is not an appropriate vehicle for purely philanthropic ends [...] Having chosen a for-profit corporate form, the Craigslist directors are bound by the fiduciary duties and standards that accompany that form [...] I cannot accept as valid for the purposes of implementing the Rights Plan a corporate policy that specifically, clearly,

and admittedly seeks not to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders.[\[15\]](#)

In light of these decisions, there is considerable uncertainty in the US corporate law as to when and to what extent corporate directors may consider the interests of non-shareholder constituencies. Hence the need for new legal solutions able to meet the unique needs of for-profit mission-driven businesses. Several alternative forms of business organisation have been created, such as hybrid not-for-profit corporations, low-profit limited liability companies (L3Cs), or flexible purpose corporations. None of these vehicles, however, has proven effective in serving the public interest and in meeting the needs of the entrepreneurs, investors, and consumers.[\[16\]](#) This is the gap that the registered B Corp, a newly introduced form of business corporation, aims to fill.

Registered B Corps: “Milton Friedman would have loved this” [\[17\]](#)

The certified B Corp programme launched by B Lab did little to alleviate the legal uncertainties regarding the compatibility between directors’ fiduciary duties and promotion of other constituencies’ interests. Something more was needed: a hybrid form of business organisation able to balance effectively the profit seeking and social benefit functions. Hence, B Lab partnered with Drinker Biddle and Reath LLP and drafted Model Legislation[\[18\]](#) for benefit corporations (often referred to as B Corps or registered B Corps).[\[19\]](#)

Certified B Corps and registered B Corps are two distinct aspects of the benefit corporation movement. The former is a marketing tool allowing mission-driven businesses anywhere in the world to be attested by B Lab as being socially responsible. The latter is a legally recognised form of for-profit corporation, available to companies with their registered offices in one of the US jurisdictions that have passed benefit corporations legislation.

Maryland was the first US state to pass benefit corporation legislation in 2010. Other states followed suit quickly. Currently, 27 states have passed benefit corporation statutes, and 14 other states are in the process of adopting them.[\[20\]](#) The benefit corporation statutes are placed within existing state corporation codes, so that the latter apply to benefit corporations in every respect except the matters explicitly covered by the former. There are no taxation benefits specific to registered B Corps.

To date, nearly 1600 benefit corporations have been incorporated across the US, including companies like Method Products, Ben and Jerry’s, Patagonia, Plum Organics, Greyston Bakery and Rasmussen College.[\[21\]](#) In July 2013, Delaware became the 19th state to enact benefit corporation legislation. The Delaware B Corp is officially named “public benefit corporation” or “P.B.C.”, but is typically be referred to as benefit corporation or B Corp. Currently there are close to 200 benefit corporations in Delaware.[\[22\]](#)

The benefit corporation statutes vary from state to state, but they have similar core requirements with respect to purpose, accountability, and transparency:

- benefit corporations must have as stated purpose the creation of a material, positive impact on society and the environment;
- in discharging their fiduciary duties, directors must take into account, in addition to shareholders’ interests, a wide range of non-financial interests;
- benefit corporations must report regularly on their overall social and environmental performance as assessed against a comprehensive, credible, independent, and transparent standard.[\[23\]](#)

The Model Legislation requires B Corps to have as stated purpose the creation of a general public benefit and, optionally, more specific public benefit purposes. The general public benefit purpose requires consideration of the effects that the business has on society and the environment. These include:

- the effects on employees of the benefit corporation, its subsidiaries, and its suppliers;
- the interests of customers;
- community and societal factors, including those of each community in which offices or facilities of the benefit corporation, its subsidiaries, or its suppliers are located;
- the local and global environment. [\[24\]](#)

Examples of specific benefits include:

- providing low-income individuals or communities with beneficial products or services;
- protecting or restoring the environment;
- promoting the arts, sciences, or advancement of knowledge. [\[25\]](#)

The idea behind requiring a general public benefit was to prevent the use of the B Corp form by corporations only interested in greenwashing. Without a general benefit requirement, some B Corps could choose only a narrow specific public benefit purpose and dismiss as irrelevant all other non-financial considerations when making decisions. [\[26\]](#)

Although directors must take into account the effects that their business decisions have on a wide range of stakeholders, these stakeholders are not owed any direct duties and normally have no enforcement rights. [\[27\]](#) The Model Legislation introduces a “benefit enforcement procedure” which specifies the circumstances under which a claim for failure to pursue the stated public benefit purpose, or a claim for breach of duty may be asserted against the B Corp or its directors or officers. [\[28\]](#)

The Delaware benefit corporation legislation differs from Model Legislation in several respects. First, Delaware requires companies to choose one or more specific public benefit purposes, rather than simply allowing them to do so. [\[29\]](#) Second, Delaware requires reporting to shareholders on a biennial rather than annual basis. [\[30\]](#) Finally, the Delaware statute does not include a special benefit enforcement proceeding. Enforcement of directors’ duties follows the general corporate law regime.

To B or not to B Corp

What are the advantages of becoming a registered B Corp, as compared to a regular for-profit corporation? From a corporate law perspective, there are several clear advantages.

First, in a takeover scenario, the target’s directors must consider the long-term interests of the benefit corporation, including the possibility that these interests may be best served by the continued independence of the benefit corporation. [\[31\]](#) This may not always be allowed in a regular corporation. The Craigslist case showed that mission-driven entrepreneurs running a regular for-profit company may not be able to maintain their business vision in the face of a hostile change of control.

In Delaware, a state without a constituency statute, in a change of control scenario the business judgment rule standard of review is replaced with the enhanced scrutiny standard. Under this standard, directors’ decision-making must satisfy the requirements laid down in *Unocal* [\[32\]](#) and *Revlon* [\[33\]](#). *Unocal* holds that a board of directors may implement anti-takeover defences only if they have reasonable grounds to believe that the proposed threatens the target’s corporate policy and effectiveness (which includes the need to protect non-financial interests), and the defensive measures are proportional to the threat. In *Revlon* the Court declared that, when the sale or break-up of the company is inevitable, the target managers’ fiduciary obligations require them to maximise the value of the existing shareholders by seeking the highest price available. Under the Delaware benefit corporation statute, however, the board’s obligation to consider other constituencies and society as a whole does not go away in the context of a merger or acquisition. Even if a board concludes that it is in the interests of

shareholders and other constituencies to sell the company, it cannot simply sell to the highest bidder, without considering which bidder is the most suitable to continue promoting the public benefit purpose.[\[34\]](#)

Second, B Corp statutes remove the existing ambiguities regarding directors' ability to consider non-financial interests as ends in themselves when making business decisions. Despite the protection that the business judgment rule offers to regular business decisions, there is a widespread belief that directors' options are constrained to acting only in the financial interests of shareholders. This impediment is removed by the new corporate form, which explicitly requires directors to take multiple interests into consideration when making decisions.[\[35\]](#)

Finally, the registered B Corp form offers to mission-driven entrepreneurs certain safeguards to maintain the public benefit focus over time. For example, the amendment of the constitutional documents to delete the public benefit purposes and terminate the B Corp status requires a super-majority of two-thirds or more of voting rights.[\[36\]](#)

Beside these legal benefits, registered B Corps reap the same marketing benefits as certified B Corps. They stand out in an increasingly confusing marketplace, by voluntarily committing to be legally bound by higher standards of corporate purpose, accountability, and transparency.

The future of benefit corporations

The benefit corporation statutes have the potential to create a meaningful impact on the corporate social responsibility movement, by giving mission-driven entrepreneurs and managers the tools to create and enforce a long-term sustainable business strategy. But will the B Corp movement garner enough traction to achieve this potential? Several challenges lie ahead.

The first challenge is viability. Will B Corps prove sufficiently attractive for investors? Even socially responsible investors will look for a record of long-term returns or strong long-term prospects that give them confidence to part with their money. Sceptics doubt that registered B Corps will be able to compete with greenwashing regular for-profit corporations. Registered B Corp, they argue, are destined to remain small businesses, since it is very unlikely that such corporations will be able to bear the costs of an initial public offer and the costs of subsequent compliance with listing requirements.[\[37\]](#)

Another test that B Corps have to pass is that of a continuing genuine commitment to the public benefit. If, despite the safety measures aimed to prevent greenwashing, B Corps will be used as window-dressing to attract ethical investors and customers, the benefit corporation movement will rapidly lose credibility among socially responsible investors and policymakers.[\[38\]](#)

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[4] See e.g. UNOPS, "[A Guide to Environmental Labels](#)" (2009)

[5] <https://www.bcorporation.net/become-a-b-corp>

[6] <https://www.bcorporation.net/>

[7] Milton Friedman, "The Social Responsibility of Business is to Increase Its Profits" New York Times Magazine, September 13, 1970

[8] William H. Clark, Jr. *et al.*, "[The Need and Rationale for the Benefit Corporation](#): Why It Is the Legal Form That Best Addresses the Needs of Social Entrepreneurs, Investors, and, Ultimately, the Public" White Paper (2013) p 5 (hereinafter "White Paper")

[9] *Dodge v. Ford Motor Company*, 170 N.W. 668 (Mich. 1919)

[10] *Ibid* at 684

[11] Leo Strine, "Making It Easier For Directors to 'Do the Right Thing'?" (2014) 4 Harvard Business Law Review 235 at 238-239 (hereinafter "Strine")

[12] Delaware remains the chosen home of more than half of all US publicly traded companies; 65% of Fortune 500 companies are incorporated in Delaware. Delaware Division of Corporations, "[Annual Report](#)" (2013)

[13] *Unocal Corp. v. Mesa Petroleum Co.* 493 A.2d 946 (Del. 1985)

[14] *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010)

[15] *Ibid.* at 34

[16] For an analysis of these organisation forms see Annex B to the White Paper.

[17] Andrew Kassoy, co-founder of B Lab, cited in B Lab, "[Maryland First State in Union to Pass Benefit Corporation Legislation](#)" CSR Wire, April 14, 2010

[18] <http://benefitcorp.net/attorneys/model-legislation> (hereinafter "Model Legislation")

[19] To avoid confusion with certified B Corps, I will refer to benefit corporations as registered B Corps.

[20] <http://benefitcorp.net/state-by-state-legislative-status>

[21] <http://benefitcorp.net/find-a-benefit-corp> (1589 as of 07 April 2015)

[22] <http://benefitcorp.net/find-a-benefit-corp> (184 as of 07 April 2015)

[23] Model Legislation ss. 401-402.

[24] Model Legislation s. 301

[25] Model Legislation s. 102

[26] <http://benefitcorp.net/attorneys/legal-faqs>

[27] S. 365 (b) of the Delaware statute expressly specifies that directors owe no duty to stakeholders: "A director of

a public benefit corporation shall not [...] have any duty to any person on account of any interest of such person in the public benefit or public benefits identified in the certificate of incorporation or on account of any interest materially affected by the corporation's conduct [...] [A director] will be deemed to satisfy such director's fiduciary duties to stockholders and the corporation if such director's decision is both informed and disinterested and not such that no person of ordinary, sound judgment would approve."

[28] Model Legislation s. 305. This section broadens the categories of persons that can bring a derivative suit against the directors of a B Corp, to include directors, 5% owners of the parent company, and other persons to which such a right is granted in the constitutive documents of the benefit corporation.

[29] The Delaware Code s. 362 (a)

[30] The Delaware Code s. 366

[31] Model Legislation s. 301 (a) (1) (vi)

[32] *Unocal Corp. v. Mesa Petroleum Co.* 493 A.2d 946 (Del. 1985)

[33] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* 506 A.2d 173 (Del. 1986)

[34] Strine at 246

[35] Model Legislation s. 301 (a)

[36] Model Legislation s. 105 (a)

[37] Lois Yurow, "[Benefit Corporations and the Public Markets – Will We Ever See a Public Benefit Corporation?](#)" Governance and Accountability Institute, Sustainability Update, November 24, 2014

[38] Strine at 249

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